

Investments

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CALLAN ASSOCIATES^{INC}

October 20, 2008

Board of Trustees
Indiana State Teachers' Retirement Fund
150 West Market Street, Suite 300
Indianapolis, IN 46204

Dear Trustees:

Callan Associates is pleased to present the Indiana State Teachers' Retirement Fund (TRF) results for the fiscal year ended June 30, 2008.

As of June 30, 2008, TRF had combined assets of \$8.5 billion, a decrease of \$416.8 million since June 30, 2007. Of the total combined assets, 62% are employer defined benefit plan assets (DB) and 38% are employee-directed defined contribution annuity savings plan assets (DC). The decrease in assets over the latest fiscal year was primarily due to negative returns experienced in world equity markets. During the previous twelve months:

U.S. economic growth slowed and world financial markets exhibited renewed volatility. Rising energy and food prices sparked global inflation fears and continued concerns about the health of the US economy sent equity markets reeling in June and weighed heavily on the US dollar as it extended its decline over the trailing 12 months.

Spurred by fears of recession, sub-prime loan contagion and large write-downs by banks, fixed income markets experienced volatility and limited liquidity which led to periodic flights to quality U.S. Treasury securities. The yield curve steepened over the trailing 12 months as the Fed continued to lower interest rates, with the 10 year Treasury note yield falling just over 1% to 3.98%.

The US equity markets had negative returns over the trailing one-year period. The S&P 500 Index, an index of domestic large capitalization stocks, lost -13.1% while smaller capitalization stocks as measured by the Russell 2000 Index, declined -16.2%. Reversing prior trends, value underperformed growth in the large cap space, but growth continued to outperform value in the small cap arena. In all indices, energy was the strongest performing sector with financials being the weakest.

Although experiencing negative returns, developed international equity markets continued to beat their domestic counterparts during the period, returning -10.6%, as measured by the MSCI EAFE (Europe, Australia, and Far East) Index; this was primarily due to strong foreign currencies relative to the weak U.S. dollar. As in the U.S., growth beat value and large beat small. Emerging markets rose and led the developed markets, returning +4.9% over the same time period, as measured by the MSCI Emerging Markets Index.

Although weakening in the second quarter of 2008, the investment grade fixed income market led by the government sector performed well over the trailing one-year period, returning +7.1% as measured by the Lehman Brothers Aggregate Index, providing an anchor of stability in uncertain times. Intermediate bonds (+7.2%) marginally outperformed long issues (+6.8%). Reflecting credit concerns, high yield bonds underperformed investment grade issues over the same period, returning -2.3%, as measured by the Lehman Brothers High Yield Bond Index. Even with sub-prime concerns, the mortgage sector, as measured by the

Report on Investment Activity

Lehman Brothers Mortgage-Backed Securities Index, returned 7.8%, slightly outperforming the broader fixed income market.

Given this market turmoil, TRF combined DB and DC assets returned -4.2%. Performance of individual employee directed DC investment choices were generally in line with market averages.

In the face of a difficult market environment, TRF DB returned -5.7%, outperforming the target benchmark return of -6.4%. Domestic large cap equity managers and the alternative investment pool had the largest positive impact on performance over the trailing one year period. Total fund performance remains favorable over longer time periods outperforming the passive benchmark index over three and five year periods.

TRF's domestic equity managers outperformed their passive target over the trailing one year period returning -11.49% versus the S&P Super 1500 Composite return of -12.7%. As a whole, the Fund's large and small cap managers outperformed their passive benchmark, but the Fund's lone mid cap manager trailed its benchmark by 4.03%.

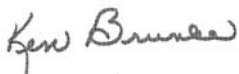
TRF's international equity managers (-9.4%) outperformed the MSCI EAFE Index (-10.6%) by 1.2% over the trailing one year period. Over the trailing three (+14.9%) and five year (+17.1%) time periods, the International Equity Composite has outperformed its benchmark.

TRF's Fixed Income Composite (+5.2%) trailed the LB Aggregate Bond Index (+7.1%) by 1.88% over the trailing twelve months; the index underperformance was primarily due to the lower exposure of TRF fixed managers in better performing US Treasury securities. Over the trailing three and five year time periods, the Fixed Income Composite outperformed the LB Aggregate by 0.41% and 0.06%, respectively.

The Funds alternatives exposure produced varying results over the trailing one year period. While the Alternatives Composite significantly outperformed its benchmark, the Real Estate and Absolute Return Composites both trailed their respective benchmarks. The Real Estate, Absolute Return and Alternatives allocations are all relatively new and have not yet reached their three year track records; performance in these asset classes typically lags in start up as managers fund their investments.

In summary, Callan Associates is pleased with the Indiana State Teachers' Retirement Fund performance over the near and long term periods. TRF's focus on risk reduction and the allocation enhancements exhibited by additional diversification into new asset classes has positively impacted TRF's performance through the recent periods of market duress.

Regards,



Ken Brunke
Senior Vice President

Summary of Investment Policies

The Board members of the Indiana State Teachers' Retirement Fund are the fiduciaries of the Fund. Indiana Code 5-10.4-3-1 states a six-member Board of Trustees will oversee TRF. Five trustees, two of whom must be Indiana educators and members of the Fund, shall be appointed by the governor. The sixth member of the Board must be a director of the budget agency or the director's designee. An executive director appointed by the governor carries out the policies set by the Board and administers the Fund on a daily basis. Pursuant to Indiana law, the executive director is also required to be a TRF member.

The Board establishes investment policies; however, Indiana law establishes guidelines on the investment of the Fund's assets. At all times, TRF must invest its assets in accordance with the "Prudent Investor" standard. Under this standard, investment decisions are based upon the same degree of care that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a similar character with similar aims.

The investment policy statement (IPS) is designed to meet the objectives of the Fund. These objectives are:

- To have the ability to pay all benefit and expense obligations when due, at a reasonable cost to members and Indiana taxpayers;
- To maintain the purchasing power of the current assets and all future contributions by producing a positive real rate of return on Fund assets;
- To enhance the funded status of the plan with regard to the accumulated benefit obligation;
- To control the costs of administering the Fund and managing the investments; and
- To meet all statutory requirements of the State of Indiana.

The Board does intend the policy to be a dynamic document, and, as such, expects to review it periodically. The Board anticipates that changes will be made from time to time to reflect experience, investment product changes, benefit and structural changes, performance, and economic conditions. The purpose of the investment policy statement is summarized below:

- Set forth the investment policies which the Board judges to be appropriate and prudent, in consideration of the needs of the Fund and applicable legal requirements, and to direct the assets of the Fund;

- Make clear distinctions between the responsibilities of the Board and those of the investment manager(s) selected by the Board;
- Establish criteria against which the investment manager(s) are to be measured;
- Communicate the investment policies, objectives, guidelines, and performance criteria of the Board to the staff, investment managers, consultants, employers, members, and all other interested parties;
- Serve as a review document to guide the ongoing oversight of the investment of the Fund; and
- Demonstrate that the Board is fulfilling its fiduciary responsibilities in the management of the investments of the Fund solely in the interests of members and beneficiaries of the Fund.

The Board recognizes that the allocation of assets, particularly the broadly-defined mix between stocks and bonds, is the most important determinant of investment rates of returns over long periods of time. The procedure for determining the allocation will consider the relevant characteristics of the liabilities and the potential assets of the Fund. An asset liability study will be conducted no less than every three years and will analyze the expected returns of various asset classes, projected liabilities, risks associated with alternative asset mix strategies and their effect on the projected market value of assets, funded status, and contributions to the Fund.

The investment portfolio includes long-term commitments to the following asset classes: domestic equity, domestic fixed income, international equity, and alternative investments.

The Board employs investment managers to implement the asset allocation through a selective and thorough search process that embodies the principles of procedural due diligence. It is the intent of the Board to encourage the participation of all qualified organizations in this process. The Board encourages investment managers to develop long-term investment strategies consistent with the guidelines outlined in the Fund's IPS, as well as governing Indiana statutes. Additionally, investment managers will adhere to and comply with the CFA Institute Performance Presentation Global Investment Performance Standards in calculating and reporting investment performance. Performance of each manager is measured against the rate of return associated with appropriate market index benchmarks and an appropriate universe or style peer group of investment managers.

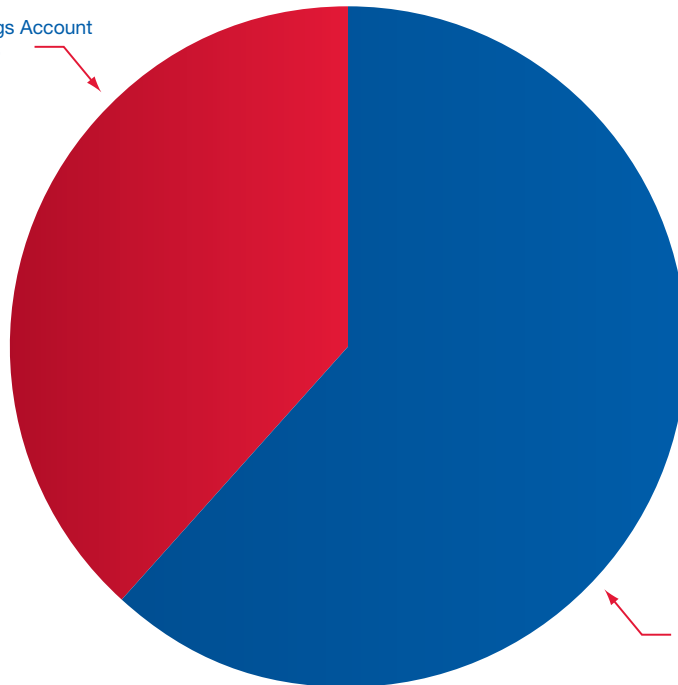
Investment Highlights

Investment Summary

Fiscal Year Ended June 30, 2008
(Dollars in millions)

| | Assets | Percent |
|--------------------------------|----------|---------|
| Defined Benefit Assets | \$ 5,252 | 61.9% |
| Annuity Savings Account Assets | 3,235 | 38.1 |
| Total Fund | \$ 8,487 | 100.0% |

Annuity Savings Account
Assets, 38.1%

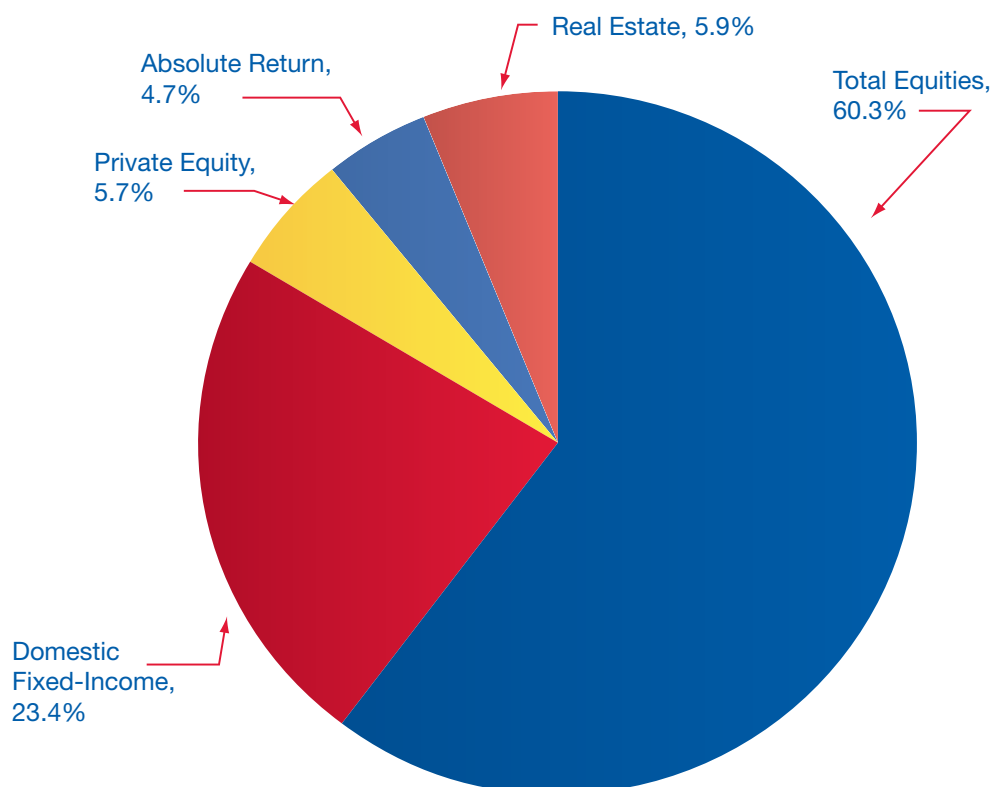


Defined Benefit
Assets, 61.9%

Defined Benefit Assets Investment Allocation Summary

| | June 30, 2008 | June 30, 2007 |
|-----------------------|---------------|---------------|
| Total Equities | 60.3% | 66.9% |
| Domestic Fixed-Income | 23.4 | 20.8 |
| Private Equity | 5.7 | 3.7 |
| Absolute Return | 4.7 | 4.2 |
| Real Estate | 5.9 | 4.4 |
| Total Fund | 100.0% | 100.0% |

Defined Benefit Assets Investment Allocation Summary



Defined Benefit Assets

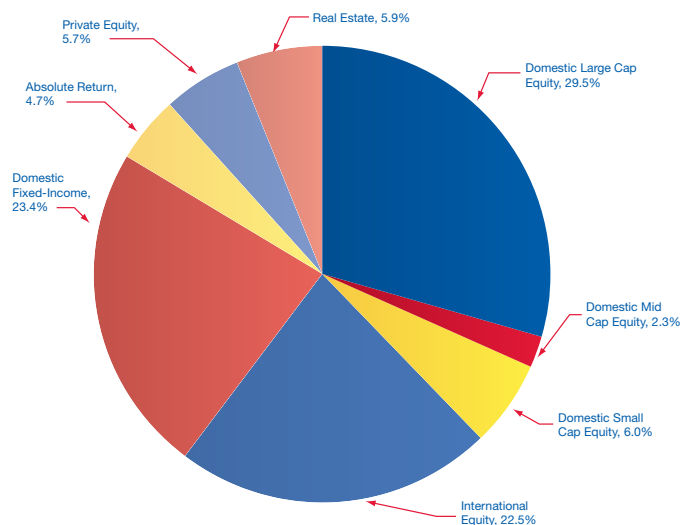
Actual vs. Target

June 30, 2008

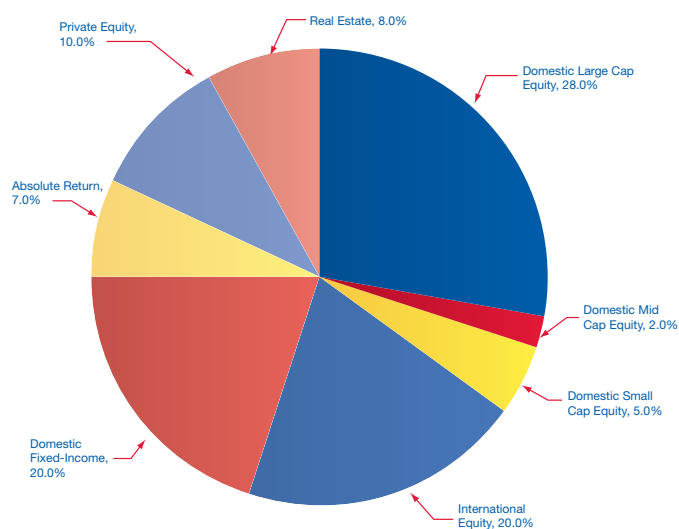
(Dollars in millions)

| Asset Class | Actual Assets | Actual Percent | Target Percent | Percent Difference |
|------------------------------|---------------|----------------|----------------|--------------------|
| Domestic Large Cap Equity | \$ 1,550 | 29.5% | 28.0% | 1.5% |
| Domestic Mid Cap Equity | 121 | 2.3 | 2.0 | 0.3 |
| Domestic Small Cap Equity | 315 | 6.0 | 5.0 | 1.0 |
| International Equity | 1,182 | 22.5 | 20.0 | 2.5 |
| Domestic Fixed-Income | 1,227 | 23.4 | 20.0 | 3.4 |
| Absolute Return | 248 | 4.7 | 7.0 | (2.3) |
| Private Equity | 297 | 5.7 | 10.0 | (4.3) |
| Real Estate | 312 | 5.9 | 8.0 | (2.1) |
| Total Defined Benefit Assets | \$ 5,252 | 100.0% | 100.0% | |

Asset Allocation Actual



Asset Allocation Target



Defined Benefit Assets
Comparative Investment Results
for Periods Ended June 30, 2008
(Percent return)⁴

| | 1 yr ¹ | 3 yr ¹ | 5 yr ¹ |
|--|-------------------|-------------------|-------------------|
| Total TRF Defined Benefit Fund | (5.7%) | 7.5% | 9.3% |
| vs. CAI Public Fund Universe Median ² | (4.8) | 6.9 | 9.1 |
| Target Reference Index ³ | (5.5) | 7.1 | 9.1 |
| Total TRF Domestic Equity | (11.4) | 5.0 | 9.0 |
| vs. CAI Public Fund Universe Median | (13.1) | 4.8 | 8.6 |
| S&P Super Composite 500 | (12.7) | 4.7 | 8.2 |
| Total TRF International Equity | (9.4) | 14.9 | 17.1 |
| vs. CAI Public Fund Universe Median | (8.8) | 14.1 | 17.5 |
| MSCI EAFE Index | (10.6) | 12.8 | 16.7 |
| Total TRF Domestic Fixed-Income | 5.2 | 4.5 | 3.9 |
| vs. CAI Public Fund Universe Median | 5.7 | 4.0 | 3.9 |
| LB Aggregate Index | 7.1 | 4.1 | 3.9 |

¹ Gross of Fees

² Universe of Public Funds

³ Composed of passive indices for each asset class held at the target asset allocation

⁴ Investment performance for the fund is based on performance calculations made by the Fund's custodian, Northern Trust. These are the 1-year, 3-year, and 5-year time-weighted rates of return for the fiscal year ended June 30, 2008.

Investment Highlights

Ten-Year Defined Benefit Assets Investment Actuarial Rates of Return (Dollars in millions)

| Year | Market Value | Rate of Return | Actuarial Assumed Rate |
|------|--------------|----------------|------------------------|
| 1999 | \$ 2,431 | 13.1% | 7.5% |
| 2000 | 2,906 | 9.9 | 7.5 |
| 2001 | 3,116 | (0.1) | 7.5 |
| 2002 | 3,032 | (3.9) | 7.5 |
| 2003 | 3,377 | 4.6 | 7.5 |
| 2004 | 3,738 | 14.8 | 7.5 |
| 2005 | 4,041 | 9.1 | 7.5 |
| 2006 | 4,521 | 11.2 | 7.5 |
| 2007 | 5,501 | 17.9 | 7.5 |
| 2008 | 5,252 | (6.0) | 7.5 |

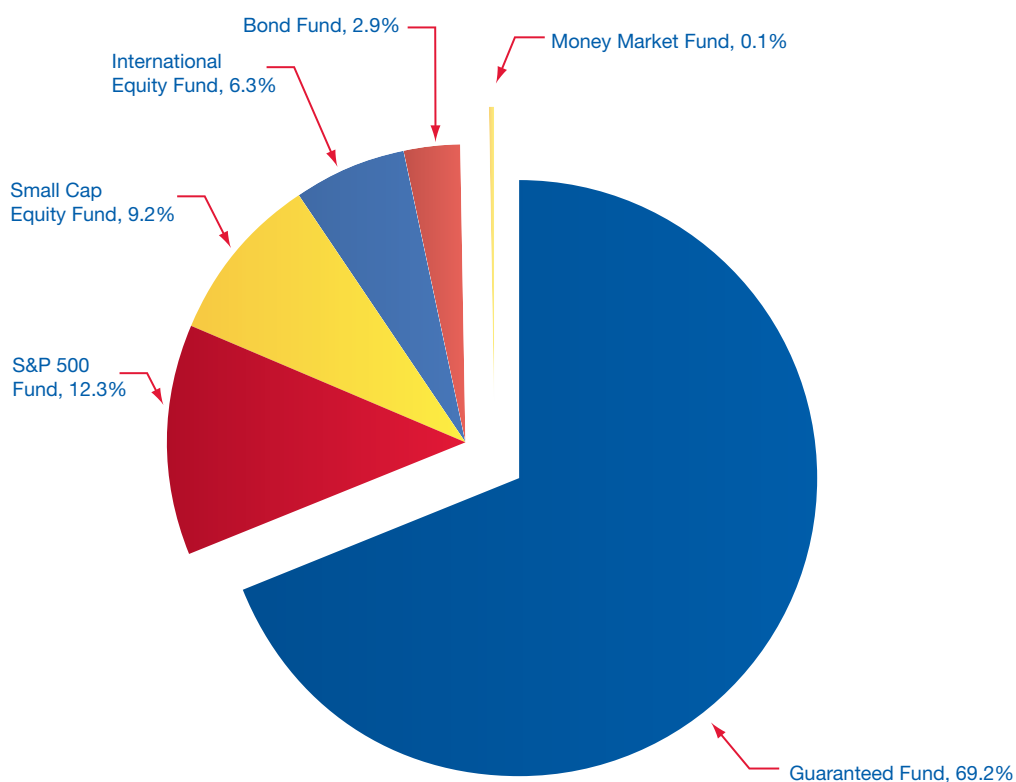
Defined Benefit Assets Investment Summary June 30, 2008 (Dollars in millions)

| | Beginning Account Balance | Ending Account Balance | Percentage of Total Fair Value |
|-----------------------|---------------------------|------------------------|--------------------------------|
| Domestic Equity | \$ 2,513 | \$ 1,986 | 37.8% |
| International Equity | 1,165 | 1,182 | 22.5 |
| Total Equity | 3,678 | 3,168 | 60.3 |
| Domestic Fixed Income | 1,145 | 1,227 | 23.4 |
| Private Equity | 205 | 297 | 5.7 |
| Absolute Return | 231 | 248 | 4.7 |
| Real Estate | 242 | 312 | 5.9 |
| Total TRF DB Assets | \$ 5,501 | \$ 5,252 | 100.0% |

Annuity Savings Account Assets

June 30, 2008
(Dollars in millions)

| | Actual Dollars | % Actual |
|---------------------------|-----------------|---------------|
| Guaranteed Fund | \$ 2,240 | 69.2% |
| S&P 500 Fund | 397 | 12.3 |
| Small Cap Equity Fund | 297 | 9.2 |
| International Equity Fund | 204 | 6.3 |
| Bond Fund | 95 | 2.9 |
| Money Market Fund | 2 | 0.1 |
| Total | <u>\$ 3,235</u> | <u>100.0%</u> |

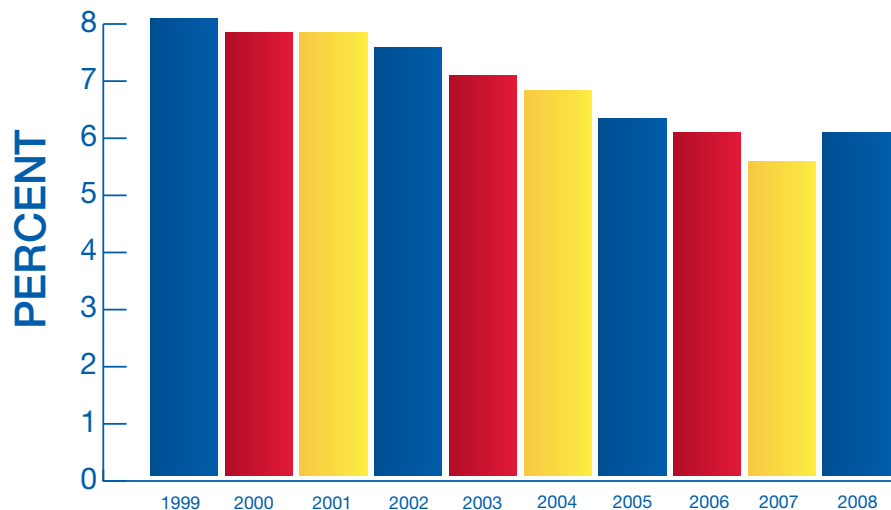


Investment Highlights

ASA Guaranteed Fund Interest Crediting Rates as of June 30

| Year | Interest Crediting Rate |
|------|-------------------------|
| 1999 | 8.00% |
| 2000 | 7.75 |
| 2001 | 7.75 |
| 2002 | 7.50 |
| 2003 | 7.00 |
| 2004 | 6.75 |
| 2005 | 6.25 |
| 2006 | 6.00 |
| 2007 | 5.50 |
| 2008 | 6.00 |

ASA Guaranteed Fund Interest Crediting Rates



Top 10 Equity Holdings for Combined DB and ASA

(by Market Value)*

6/30/2008

| Company | Shares | Market Value |
|------------------|-----------|---------------|
| Exxon Mobil | 920,507 | \$ 81,124,399 |
| Microsoft | 1,309,252 | 36,017,532 |
| GE | 1,315,525 | 35,111,356 |
| Chevron | 321,819 | 31,901,896 |
| Total SA | 345,826 | 29,531,745 |
| Proctor & Gamble | 437,498 | 26,604,249 |
| IBM | 212,565 | 25,195,356 |
| ConocoPhillips | 261,224 | 24,656,938 |
| AT&T | 545,205 | 18,367,940 |
| Novartis | 279,366 | 15,427,388 |

*A complete list of portfolio holdings is available upon request.

Top 10 Fixed Income Holdings for Combined DB and ASA

(by Market Value)*

6/30/2008

| Name | Coupon | CUSIP/ SEDOL | PAR | Market Value |
|-------------------------------|--------|-----------------|----------------|----------------|
| FNMA Single Family Mortgage | 5.000% | B01DWZ6 | \$ 233,505,000 | \$ 223,800,065 |
| FNMA Single Family Mortgage | 4.500 | 01F042673 | 204,865,000 | 189,820,124 |
| FNMA 30 Year Pass-Through | 5.500 | B01NT00 | 105,220,000 | 103,707,463 |
| GNMA I Single Family Mortgage | 5.000 | 01N050685 | 99,940,000 | 96,567,025 |
| GNMA I Single Family Mortgage | 5.500 | 01N052681 | 75,965,000 | 75,347,784 |
| GNMA I Single Family Mortgage | 6.000 | 01N060684 | 58,985,000 | 59,685,447 |
| FHLMC Preassign | 5.125 | B28K7D7 | 54,260,000 | 55,744,716 |
| FNMA Pool #381800 | 6.500 | 31407JDD1 | 44,438,319 | 45,812,263 |
| FNMA Pool #889139 | 5.500 | 31410GZC0 | 44,866,863 | 44,361,214 |
| FNMA Bond | 6.250 | 2479471 | 38,025,000 | 43,018,063 |

*A complete list of portfolio holdings is available upon request.

Schedule of Fees

| Fees by Asset Class | |
|-----------------------------|----------------------|
| Asset Class | Amount Paid in Fees |
| Domestic Large Cap Equity | \$ 4,809,076 |
| Domestic Mid Cap Equity | 394,190 |
| Domestic Small Cap Equity | 4,526,430 |
| International Equity | 6,772,363 |
| Domestic Fixed Income | 3,077,392 |
| Real Estate | 1,166,024 |
| Private Equity | 1,886,976 |
| Absolute Return | 3,534,353 |
| Partnership Management Fees | 6,240,783 |
| Total Fees Paid | <u>\$ 32,407,587</u> |

Custodian**Northern Trust**

50 South LaSalle Street
Chicago, IL 60675

Consultant**Callan Associates, Inc.**

120 North LaSalle Street
Suite 2100
Chicago, IL 60602

Domestic Equity**Barclays**

45 Fremont Street
San Francisco, CA 94014

Barrow Hanley

2200 Ross Avenue
31st Floor
Dallas, TX 75201

Clarivest

11452 El Camino Real
Suite 250
San Diego, CA 92130

Columbus Circle

Metro Center
One Station Place
Stamford, CT 06902

Cortina

330 East Kilbourn
Suite 850
Milwaukee, WI 53202

Earnest

1180 Peachtree Street
Suite 2300
Atlanta, GA 30309

Franklin

One Boston Place
29th Floor
Boston, MA 02108

INTECH

2401 P.G.A. Boulevard
Suite 100
Palm Beach Gardens, FL 33410

Jacobs Levy

100 Campus Drive
Florham Park, NJ 07932

JP Morgan Asset Management

245 Park Avenue
7th Floor
New York, NY 10167

NorthPointe

101 West Big Beaver
Suite 745
Troy, MI 48084

PanAgora

470 Atlantic Avenue
8th Floor
Boston, MA 02110

PIMCO

840 Newport Center Drive
Newport Beach, CA 92658

QMA

Two Gateway Center
4th Floor
Newark, NJ 07102

Rhumblin

30 Rowes Wharf
Boston, MA 02110

Turner

1205 Westlakes Drive
Suite 100
Berwyn, PA 19312

Wells

3 Parkwood Crossing
Suite 310
Indianapolis, IN 46240

Investment Professionals

International Equity

Alliance Bernstein

1345 Avenue of the Americas
35th Floor
New York, NY 10105

Fisher

13100 Skyline Boulevard
Woodside, CA 94062

Gryphon

20 Bay Street
Suite 1905
Toronto, ON M5J2N8
Canada

Manning & Napier

360 Central Avenue
Suite 1500
St. Petersburg, FL 33701

State Street Global

1 Lincoln Street
33rd Floor
Boston, MA 02111

Fixed Income

Alliance Capital

1345 Avenue of the Americas
35th Floor
New York, NY 10105

Reams

227 Washington Street
Suite 666
Columbus, IN 47201

Taplin, Canida & Habacht

1001 Brickell Bay Drive
Suite 2100
Miami, FL 33131

Alternatives

Private Equity

Credit Suisse

315 Park Avenue South
12th Floor
New York, NY 10010

Hamilton Lane

7777 Fay Avenue
Suite 206
La Jolla, CA 92037

Portfolio Advisors

9 Old Kings Highway South
Darien, CT 06820

Real Estate

LaSalle Investment Management

200 East Randolph Drive
Chicago, IL 60601

Prudential Real Estate

8 Campus Drive
Parsippany, NJ 07054

RREEF

975 North Michigan Avenue
41st Floor
Chicago, IL 60611

TA Associates

200 Clarendon Street
56th Floor
Boston, MA 02116

Absolute Return

Bridgewater

1 Glendinning Place
Westport, CT 06880

GMO

40 Rowes Wharf
Boston, MA 02110

